

A PROHIBITION ON
DISCRIMINATORY AD VALOREM
TAXATION OF INTERSTATE
TELECOMMUNICATIONS

ENCOURAGING INVESTMENT IN INTERNET INFRASTRUCTURE
THROUGH EQUITABLE STATE TAX TREATMENT

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ANDAL
PROPOSAL 2

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INTRODUCTION

Fellow Commissioners, this proposal will encourage investment in Internet infrastructure by prohibiting discriminatory state ad valorem property taxation of interstate telecommunications. It extends the same protection against discrimination which federal law currently provides to railroads, airlines and other industries critical to interstate commerce.

Over the last three decades, the telecommunications industry has been transformed by deregulation and changing technologies from a regulated monopoly into a highly competitive industry. Unfortunately, state and local property tax practices have not kept pace with this transformation. Instead, the telecommunications industry has been harmed by an antiquated state and local property tax system that unfairly discriminates against them compared to similarly situated taxpayers.

As Internet access is highly dependent on the telecommunications backbone, any excessive taxes on telecommunications restricts access to the Internet, either through higher costs to users or under-investment in capital expansion in telecommunications infrastructure. Available and affordable Internet access to Americans requires a uniform and nondiscriminatory tax burden on telecommunications service providers.

Other interstate industries faced with the same inequitable tax treatment have sought and received federal legislation prohibiting state and local government from applying property taxes to them in a manner different than to other business property generally. The first of these was the

railroad industry, which in 1976 received property tax protection in the

Railroad Revitalization and Regulatory Reform Act (the "4R Act"). This proposal adopts a similar approach for telecommunications, one that has proven to be effective at halting discrimination and encouraging investment while respecting state taxing prerogatives to the maximum extent possible.

STATE PROPERTY TAX DISCRIMINATION AGAINST INTERSTATE TELECOMMUNICATIONS

In the 1800's, states discovered that traditional methods of property tax valuation did not work well when applied to interstate railroads. Local governments found that since only parts of the railroad (such as a section of track or a single station) laid within their jurisdictions, they were forced to value this property as if it were scrap (so-called "salvage value"). Even when these salvage values were added together, the sum did not equal the total value of the component parts of the railroad as an integrated transportation system. To address this problem, "unit valuation" was born. Under unit valuation, the railroad was first valued as a single operating unit, then the total system value was allocated across all of the jurisdictions in which the railroad had property.

Over time unit valuation was applied to many other types of investor-owned utilities, including telecommunications companies. They shared certain characteristics. Most were regulated monopolies, which were guaranteed a profit based on their capital investment (rate base) -- distinguishing them from other types of businesses. These types of utilities rarely changed hands in the marketplace, making it very difficult to value them by referring to comparable sales of other property, a method typically used to value business property.

States also realized that regulated utilities provided an easy target for discriminatory property taxation. First, they were often "out-of-state" companies, with little political influence in their state. Second, by nature of their businesses, it was usually impractical to move their operations simply to avoid discriminatory property taxes. Finally, as property taxes were usually included in rate base and were shifted to customers in the form of higher utility rates, states often use discriminatory utility property taxes to generate higher revenues to expand government programs without voter approval for higher taxes.

Discriminatory property taxation usually takes two forms. First, as part of the concept of unit valuation, many states tax the intangible assets of public utilities while not taxing the same assets held by other businesses. These intangible assets, which include assets as diverse as federal operating

licenses to an assembled work force, are often the most valuable portion of the utility's business. Second, states often apply a higher tax rate to the tangible personal property held by utility companies than that held by other business taxpayers generally. A recent study by the Committee On State Taxation (COST) illustrates this fact.¹

The COST study found 15 states tax telecommunications tangible personal property at a higher rate than other business personalty and 14 states levy an ad valorem tax on telecommunications intangible property at a higher rate than other business intangibles. Please note the following chart:

States that tax telecommunications companies' Tangible personal property at a higher rate:

1. Alabama
2. Arizona
3. Arkansas
4. Colorado
5. Florida
6. Kansas
7. Maryland
8. Mississippi
9. Missouri
10. New Mexico
11. South Dakota
12. Tennessee
13. Texas
14. Virginia
15. Washington

States that tax telecommunications companies' intangible property at a higher rate:

1. Colorado
2. Kentucky
3. Louisiana
4. Michigan
5. Mississippi
6. Montana
7. North Carolina
8. Nebraska
9. Oregon
10. South Carolina
11. South Dakota
12. Utah
13. West Virginia
14. Wyoming

¹ Committee On State Taxation, *50-State Study and Report on Telecommunications Taxation*, September 7, 1999.

When the Penn Central Railroad collapsed in the 1970's, Congress responded by passing the Railroad Revitalization and Regulatory Reform Act (49 U.S.C. Section 11503). In order to encourage investment in the nation's deteriorating rail system, the 4-R Act contained provisions which prohibited states from applying discriminatory property taxes to railroads. It further allowed challenges to those taxes to be brought in federal district court, and allowed federal courts to enjoin the collection of such taxes while litigation was pending.

Interstate airlines, bus companies and trucking companies have received similar federal protection from Congress. The interstate telecommunications and natural gas pipeline industries came close to receiving a similar federal statute in the late 1980's.² They eventually abandoned their efforts and instead have focused on property tax reform efforts on a state-by-state basis.

In light of the recent deregulation of the industry, state and local government excuses for different and discriminatory property tax treatment of telecommunications service providers are no longer relevant. Telecommunications is now made up of many competitive companies with a substantial share of their value tied up in intangible assets. Property taxes are borne by shareholders, not ratepayers. There is no guaranteed profit anymore, and market participants are forced to make multibillion dollar investment in infrastructure to stay competitive. In this new, deregulated and competitive world, telecommunications companies are entitled to the same property tax treatment as other intrastate businesses. In short, the time has come to apply the 4-R tax treatment to the telecommunications industry.

² See H.R. 2092 (99th Congress); H.R. 2953 (100th Congress); H.R. 2378 (101st Congress).

THE IMPACT OF DISCRIMINATORY PROPERTY TAXATION

1. Exporting Tax Costs to Non-Resident Consumers.

Non-resident customers are the unwitting victims of discriminatory property tax practices. Since long distance rates are typically set nationwide, the tax burden is spread out across the country, regardless of the tax burdens imposed in the customers' local jurisdiction.

2. Discriminatory Taxes Result in Rate Increases Furthering Digital Divide. The poor spend a higher portion of their incomes on utilities than wealthier Americans. To the degree that discriminatory property taxes are wholly or partially passed on to customers in the form of higher utility rates, they constitute a regressive tax aimed at the nation's less fortunate citizens. Discriminatory property tax increases telephone rates on the poor and exacerbates the digital divide.

3. Competition is Hindered. Telecommunications service providers that are subject to property tax discrimination are not able to compete on a level playing field with those that are not. In this rapidly evolving industry, different types of companies are now providing an array of telecommunications services. If similar telecommunications entities are taxed differently, and the tax differentials are substantial, distortions in the marketplace result.

The impact of discriminatory property taxation of telecommunications carriers on open-market competition has been a longstanding problem. In testimony provided eleven years ago to the House Judiciary Committee, Pete Rinehart, Corporate Vice President for Tax Planning and Compliance with AT&T, said the following:

Discriminatory taxation of interstate commerce represents a significant problem for the long distance telecommunications industry and its customers to whom the taxes are exported. Further, dramatic changes have taken place in recent years that tend to exacerbate the impact of such taxation. . . . In a competitive environment such as this, it is essential that tax policy not be perpetuated in a manner that increases costs for one type of competitive product or service to the competitive advantage of others.³

³N. Rinehart, Jr., Corporate Vice President for Tax Planning and Compliance, AT&T, statement to the Judiciary Subcommittee on Monopolies and

4. Existing Remedies Inadequate. Even if a strong case against a discriminatory property tax could be made, current federal law severely curtails such challenges being heard in federal court unless an extremely high showing is made that the taxpayer has no "plain, speedy and efficient remedy" available. As a result, these taxpayers must file an appeal in the State court system and perhaps multiple local administrative agencies often composed of the same people who assess the property, thus making it more difficult to gain a fair hearing. Without federal protections, telecommunications companies are forced to pay the discriminatory taxes before seeking judicial review.

5. Inadequate Investment in Internet "Backbone"

Infrastructure. The net result of all of these factors is a danger that telecommunications companies will make inadequate investment in the infrastructure backbone which is essential to the development of the Internet. Discriminatory taxation of telecommunications property reduces return on such property and investment in the Internet backbone is diminished as a result. Improved customer access to the Internet, the World Wide Web and electronic commerce will only come through lower costs associated with increased competition, and adequate investment. Discriminatory property taxation of telecommunications companies stands squarely in the way.

THE SOLUTION

A federal legislative proposal to extend 4-R property tax treatment to telecommunications carriers engaged in interstate commerce is sorely needed to protect investment in the Internet backbone. My proposal affords telecommunications companies the same tax treatment as their competitors for property tax purposes. Tax discrimination will be eliminated, and increased investment encouraged. Ultimately, this policy will result in expansion of the Internet and improved access for all Americans.

As was made clear in the first two Commission hearings, the impact of discriminatory property taxation on investment in Internet expansion remains a serious problem. The Commission has the opportunity and the forum to advance proposals to ensure an equitable property tax system for those entities engaged in interstate telecommunications services in the electronic marketplace. Protection against discrimination through the adoption of this proposal should be a component of the Commission's final recommendations.

ANDAL PROPOSAL 2

TITLE 28 - JUDICIARY AND JUDICIAL PROCEDURE PART IV - JURISDICTION AND VENUE CHAPTER 85 - DISTRICT COURTS; JURISDICTION

Sec. 1341. Taxes by States

(a) The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

(b)(1) Notwithstanding the provisions of subsection (a), and without regard to the amount in controversy or the citizenship of the parties, the district courts of the United States have jurisdiction, concurrent with other jurisdiction of courts of the United States and the States, to enjoin, suspend, restrain, or set aside any tax of any State or local unit of government which is in violation of paragraph (3) of this subsection. Relief may be granted under this subsection if the ratio of assessed value to true market value of telecommunications carrier property exceeds, by at least 5 percent, the ratio of assessed value to true market value of other commercial and industrial property in the assessment jurisdiction. The burden of proof in determining such assessed value of other commercial and industrial property shall be governed by State law. If the ratio of assessed value of other commercial and industrial property in the assessment jurisdiction to the true market value of all other commercial and industrial property cannot be determined to the satisfaction of the district court through the random-sampling method known as a "sales assessment ratio study," then the court shall hold unlawful and a violation of this subsection -

- (A) an assessment of the telecommunications carrier property at a value that has a higher ratio to the true market value of the telecommunications carrier than the assessed value of other commercial and industrial property in the assessment jurisdiction has to the true market value of such other commercial and industrial property; and
- (B) the collection of an ad valorem property tax on the telecommunications carrier at a tax rate that exceeds the tax rate applicable to other taxable property in the taxing district.

(2) Any sales assessment ratio study conducted pursuant to this subsection shall be carried out under statistical principles applicable to such study.

(3) The Congress finds and declares that the acts specified in subparagraphs (A) through (D) of this paragraph unreasonably burden and discriminate against interstate commerce. No State, subdivision of a State, or authority acting for a State of subdivision thereof may -

- (A) assess telecommunications carrier property at a value that has a higher ratio to the true market value of the telecommunications carrier property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property;
- (B) levy or collect a tax on an assessment that may not be made under this paragraph;
- (C) levy or collect an ad valorem property tax on telecommunications carrier property at a tax rate that exceeds the tax rate applicable to other commercial and industrial property in the same assessment jurisdiction; and
- (D) levy or collect any new tax, or increase the rate or remove exemptions from any tax, that discriminates against a telecommunications carrier subject to the jurisdiction of the Federal Communications Commission.

(4) As used in this subsection -

- (A) "assessment" means valuation for a property tax levied by a taxing district;
- (B) "assessment jurisdiction" means a geographical area in a State used in determining the assessed value of a property for ad valorem taxation;
- (C) "telecommunications carrier property" means property which is owned or used by a telecommunications carrier and which operates in interstate commerce or provides sales or services to customers engaged in interstate commerce;
- (D) "commercial and industrial property" means all real and personal property devoted to a commercial or industrial use other than telecommunications carrier property and land used primarily for agricultural purposes or timber growing;
- (E) "telecommunications carrier" has the meaning given such term in section 3 of the Communications Act of 1934 (47 U.S.C. 153) which are engaged in providing

telecommunications services, who are subject to the jurisdiction (in whole or in part) of any state or federal regulatory authority and which operates in interstate commerce or provides sales or services to customers engaged in interstate commerce. "new tax" means any tax which is enacted after the date of enactment of this subsection.

(c) This section, and the amendments made by this section, shall become effective on January 1, 2002.

DISCUSSION OF PROPOSED PROPERTY TAX TREATMENT

The proposed legislation amends 28 U.S.C. §1341 to add a new subsection (b). As stated, this provision is modeled after three previously enacted statutes limiting state taxation of interstate carrier property: railroads (49 U.S.C. §11501), motor carriers (49 U.S.C. §14502), and air carriers (49 U.S.C. § 40116). It is intended that the new subsection (b) will be applied and interpreted in the same manner as the earlier statutes where it adopts the same language.

Paragraph (1) provides that the U.S. district courts have concurrent jurisdiction to adjudicate violations of the tax limitations set forth in this legislation, without regard to the amount in controversy or the citizenship of the parties. It is not intended to include damages or any other type of relief. The U.S. district courts have jurisdiction under paragraph (b)(1) to enjoin violations involving both tax rates and assessment valuations. For assessment cases, the U.S. district court jurisdiction is limited to cases in which the ratio of assessed value to true market value of interstate telecommunications property exceeds the same ratio for other commercial and industrial property by at least 5 percent. It does not however, limit a U.S. district court's jurisdiction to enjoin state violations involving tax rates.

Paragraph (3) contains the substantive provisions of the legislation and provides that certain state taxes on interstate telecommunications property discriminate against interstate commerce and are prohibited, namely;

(A) assessing telecommunications carrier property at a higher ratio to true market value than other commercial and industrial property;

(B) levying or collecting a tax based on such an assessment;

(C) taxing telecommunications carrier property at a rate higher than the rate imposed on other commercial and industrial property; or

(D) levying or collecting any new tax, increasing the rate of an existing tax, or removing an exemption in a way that discriminates against interstate telecommunications carriers.

Subparagraph (D) uses "new tax" instead of "any other tax" and would not affect or prohibit any other state or local taxes, apart from ad valorem taxes, that presently discriminate against interstate telecommunications carrier property. It

would however, prohibit any new taxes that discriminate against telecommunications carriers when compared to the tax on other commercial and industrial property.

Subparagraph (4) is the definition section. Some of the terms are identical to or modeled after definitions used in predecessor statutes and should be interpreted in the same manner.

Subsection (c) provides the enactment date of the subsection to take effect on January 1, 2002, in order to make the legislation prospective and to give the affected states time to make necessary adjustments to conform to the section.